AGUINALDO INDUSTRIES
CORPORATION (FISHING
NETS DIVISION),
Petitioner,

versus CTA CASE NO. 1636

June 29, 1968

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - x

D E C I S I O N

This is an appeal from a decision of respondent Commissioner of Internal Revenue requiring petitioner Aguinaldo Industries Corporation to pay the sum of ₱17,133.00 as deficiency income tax for the year 1957, exclusive of the statutory penalties incident to delinquency.

At the outset, it should be stated that this case was submitted by petitioner for judgment on the pleadings and records.

The first issue that confronts us is one of jurisdiction. Respondent contends that the present petition was filed beyond the 30-day period prescribed in Section 11 of Republic Act No. 1125. In this respect, it appears that the Court re-set this case for hearing on this point on May 4, 1968. Petitioner then presented evidence, which was not contradicted or impugned by respondent, that it received the letter containing the decision of respondent dated March 15, 1965 on April 26, 1965. Since the petition for review was filed on May 20, 1965, which is well within the thirty-day period provided in Section 11 of Republic Act No. 1125, this Court has, therefore, jurisdiction to entertain the present appeal.

The second issue that confronts us refers to the merit of this case. It appears that petitioner Aguinaldo Industries Corporation is a domestic corporation organized in accordance with law with principal place of business in Parang, Marikina, Rizal. It is engaged in two lines of business, namely: (a) the manufacture of fishing nets, a tax-exempt industry, and (b) the manufacture of furniture. Its business of manufacturing fishing nets is handled by its Fish Nets Division, while the manufacture of furniture is operated by its Furniture Division. For accounting purposes, each division is provided with separate books of accounts as required by the Department of Finance. Under the company's accounting method the net income from its Fish Nets Division, miscellaneous income of the Fish Nets Division, and the income of the Furniture Division are computed individually.

Previously, petitioner acquired a parcel of land in Muntinglupa, Rizal, as site of its fishing net factory. This transaction was entered in the books of the Fish Nets Division of the Company. Later, when another parcel of land in Marikina Heights was found supposedly more suitable for the needs of petitioner, it sold the Muntinglupa property. Petitioner derived profit from this sale which was entered in the books of the Fish Nets Division as miscellaneous income to distinguish it from its tax-exempt income.

For the year 1957, petitioner filed two separate income tax returns - one for its Fish Nets Division and another for its Furniture Division. After investigation of these returns, the examiners of the Bureau of Internal Revenue found that the Fish Nets Division deducted from its gross income for that year the amount of ₱61,187.48 as additional remuneration paid to the officers of petitioner. The examiner further found that this amount was taken from the net profit of an isolated transaction not in the course of or carrying on of petitioner's trade or business. He reports it as part of the selling expenses of the land in Muntinglupa, Rizal, the details of said transaction being as follows:

Selling price of land		₱432,031.00
DEDUCT:		
Purchase price of land	₱71,120.00	
Registration, documentary stamps and other expenses	191.05	
Relocation survey	450.00	
	₱71,761.05	
ADD: SELLING EXPENSES		
Commission . . .	51,723.72	
Documentary stamps	2,294.05	
Topographic survey	450.00	
Officers' remuneration	61,187.48	186,416.30
NET PROFIT		₱244,614.70

(Pages 48-49, BIR rec.)

Upon recommendation of aforesaid examiner that the said sum of ₱61,187.48 be disallowed as deduction from gross income, petitioner asserted in its letter of February 19, 1958, that said amount should be allowed as deduction because it was paid to its officers as allowanse or bonus pursuant to section 3 of its by-laws which provides as follows:

> "From the net profits of the business of the Company shall be deducted for allowance of the President - 3%, for the First Vice-President - 1%, for the Second Vice-President - 1%, for the members of the Board of Directors - 10% to be divided equally among themselves, for the Secretary of the Board - 1%, for the General Manager - 2%, for two Assistant General Managers - 2%." (Page 2, Petitioner's memorandum.)

In this connection, petitioner explains that to arrive at the aforesaid 20% it gets 20% [illegible] the same to 20% of the profit of the fish net venture. The ₱61,187.48 which is the basis of the assessment of ₱17,133.00 does not even represent the entire 20% allocated as allowance in section 3 of its by-laws but only 20% of the net profit of the non-exempt operation of the Fish Nets Division, that is, 20% of ₱305,869.89, which is the sum total of ₱305,802.18 representing profit from the sale of the Muntinglupa land, ₱45.21 representing interest on savings accounts, and ₱90.00 representing dividends from investments of the Fish Net Division.

Parenthetically, on the bases of the records, the sum actually in question is not ₱61,187.48 but only ₱61,160.44, which is 20% of the profit from the Muntinglupa land sale. The deficiency assessment should be ₱17,124.93 instead of ₱17,-133.00 (p. 82, BIR rec.). This is so because it is only the deductibility of the additional compensation from the profit of ₱61,160.44 of the Muntinglupa land sale that is questioned. And it is well to remember at this juncture that aside from this ₱61,160.44 which petitioner allocated as additional compensation to its officers, petitioner also gave a commission of ₱51,732.72 to the broker who effected the sale.

Tax deductions for compensation are governed by Section 30 of the Tax Code. The deductibility from gross income of additional remuneration or bonuses granted to officers and employees of a commercial enterprise is, under Section 30 aforesaid as interpreted by our Supreme Court, subject to three condition precedents, to wit: (1) the payment of the bonuses is in fact compensation; (2) it must be for personal services actually rendered; and (3) the bonuses, when added to the salaries are reasonable when measured by the amount and quality of the services performed with relation to the business of the particular taxpayer (Kuenzle & Streiff v. Collector of Internal Revenue, G. R. Nos. L-12010 & L-12113, October 20, 1959). By-laws of corporation cannot render nugatory these principles (Botany Worsted Mills v. United States, 73 U. S. L. ed 282).

It is not controverted that the sum of ₱61,160.44 in question comes from the net profit of the sale of the Muntinglupa lot for the purpose of acquiring a better site for petitioner's fish net factory. The record shows that said sale was effected, not by petitioner's officers, but through a broker who received a commission of ₱51,723.72 for the transaction. On the other hand, there is no evidence of the service rendered by said officers on which to justify their additional remuneration for the profits of said sale. And the sale was scarcely related to the operation of the business for which petitioner was organized, to wit: furniture and fish net business. Needless to say, under the facts of this case, it cannot be said that the additional compensations of petitioner's officers are for actual personal services, and when added to their salaries are reasonable when measured by the amount and quality of the services performed with relation to the petitioner's business. To restate a familiar rule, the taxpayer must show that its claimed deductions clearly come within the language of the law, since allowances, like exemptions, are matters of legislative grace (Mertens, op. cit., Vol. 4, 1958 Ed., Sec. 25.03, Chap. 25, pp. 7, 8-9, Mertens, Ibid., Vol. 1, 1956 Ed., Sec. 3.09, Chap. 3, pp. 15-16; Capitol Indemnity Insurance Co. v. Comm., 25 BTA 147, 150) and moreover the propriety of the deduction is a contested issue in the pleadings.

There are good reasons for limiting the additional compensation in the form of percentages of the profits from the operation of the business of petitioner. The policy of agreeing to pay additional compensation on the percentage basis before it is earned is based on sound business principles primarily. Its object is to stimulate the activity, diligence, and ambition of the officers or employees and to enable the employer to justly compensate its deserving officers and employees (William S. Gray & Co. v. United States, 35 F (2d) 968). On this premise section 3 of petitioner's by-laws should be interpreted as referring to profits from the operation of its furniture and fish net business. Indeed, petitioner's pretension can result to incongruous situations. Petitioner's officers will still receive additional compensation although it suffered losses from operation through their inefficiency or negligence, as long as the profits from the sale of its capital investments are more than its losses from operation - a situation which is a travesty of the primary purpose of bonuses and additional remuneration.

WHEREFORE, reducing the assessment to ₱17,124.93, the Court hereby affirms the decision appealed from in every other respect.

SO ORDERED.

Quezon City, June 29, 1968.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge